DOW THEORY LETTERS INC.

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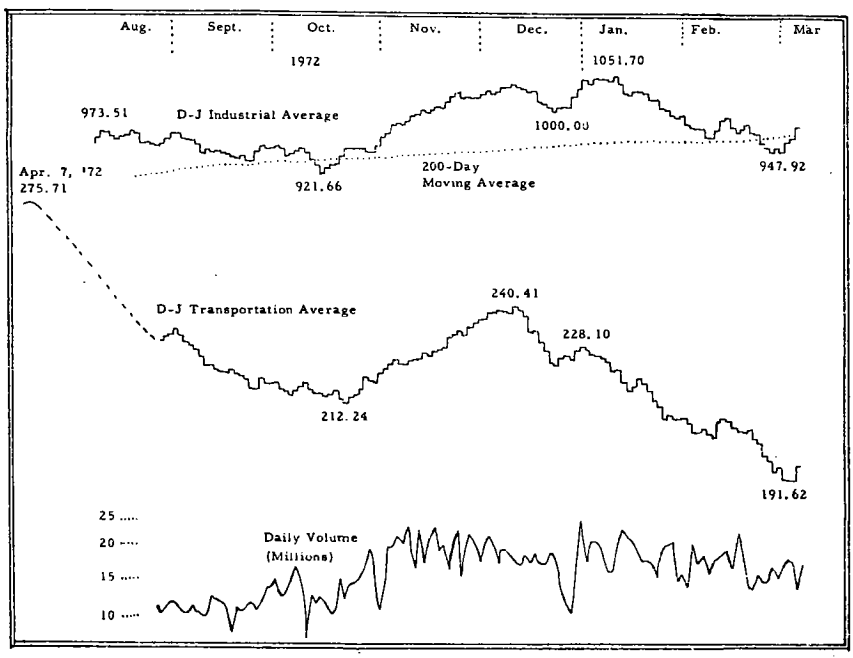
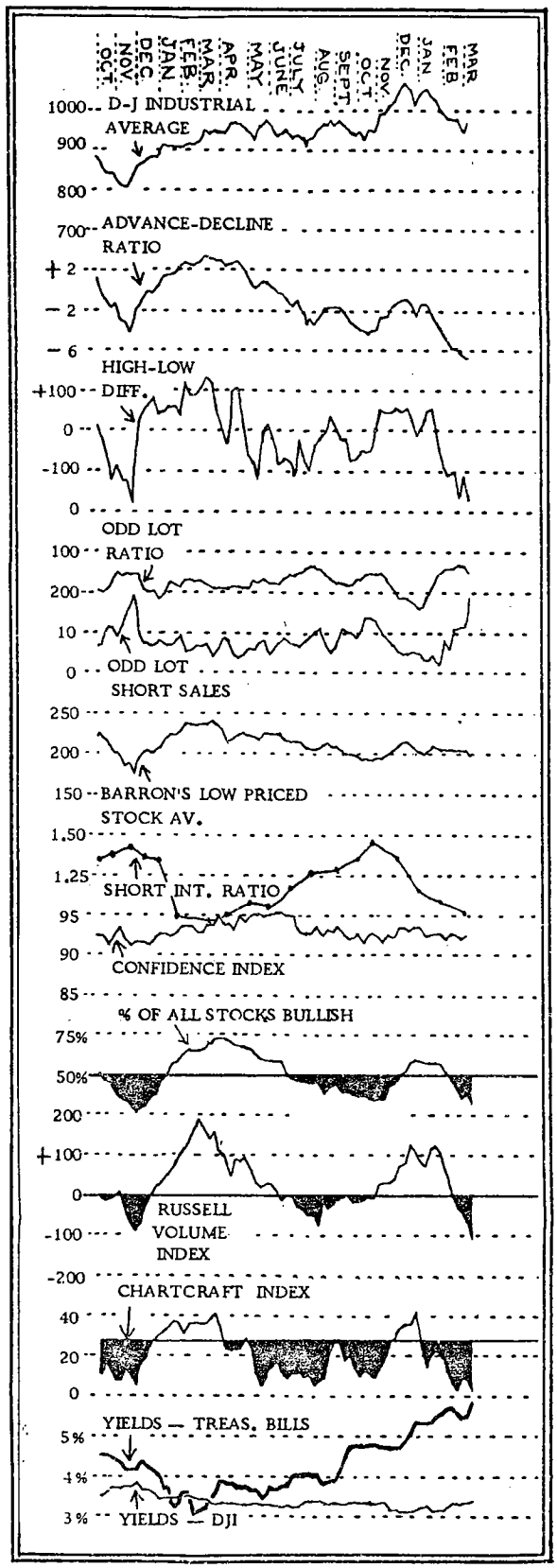
Feb. 22, DJIA 959.89, PTI 934, A-D ratio -6.28
Mar. 1, DJIA 961.32, PTI 912, A-D ratio -7.56

CHOICES: I am going to start this report by disclosing Russell's Second Law, which is, "Every great nation must possess one of the three following assets: (1) Almost unlimited natural resources, (2) a genius for producing what the rest of the world needs and will pay for, (3) outstanding modesty or even humility." The US no longer falls into the first class, and it will shortly have to choose between the other two.

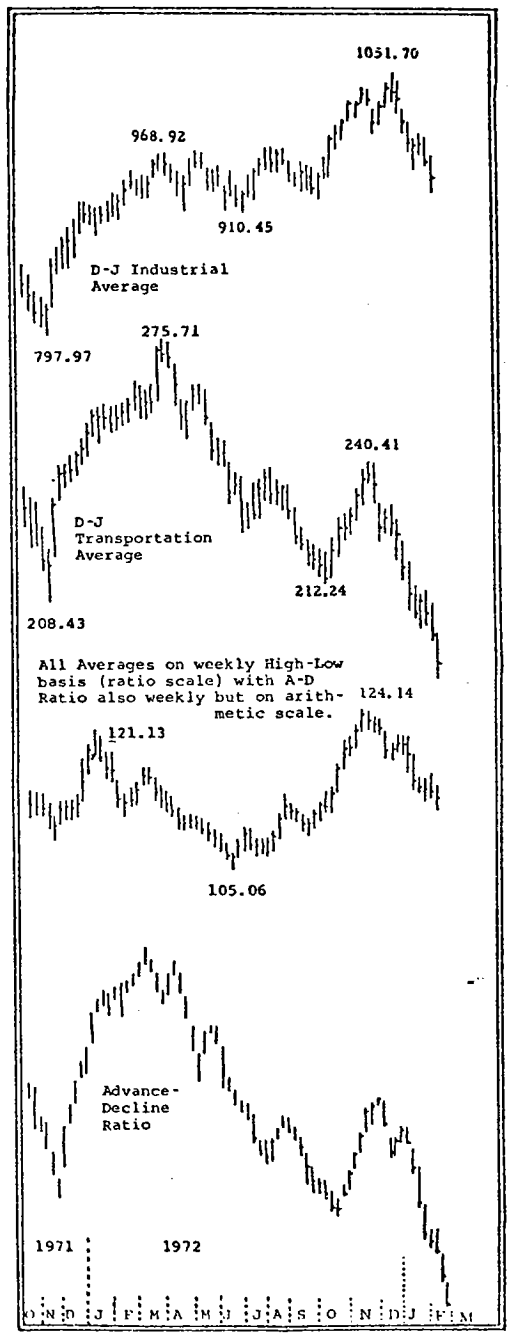
THE MARKET: This market is moving into a position whereby a major or primary signal can be given. There is no questioning the fact that over the past decade signals in the classical Dow Theory sense have been difficult and often anything but clearcut. This is undoubtedly because of the drastic changes which have taken place in the marketplace. There is the rise of the great institutional buyers, the mutual funds, the pension funds and the bank funds. On top of this the market has expanded to include over thirty million stockholders, a number never seen before on Wall Street. Finally, there is the unprecedentedly wide and almost instant distribution of news plus the Government's all-out entrance into the business of news manipulation. All of these make the market different in many ways than it was during the time of Charles Dow, William Hamilton or Robert Rhea.

Nevertheless, there are times when the price structure lends itself outstandingly to classical analysis and interpretation. For instance, under Dow Theory a movement is taken to end at the point of the last confirmed highs (or lows) in the Industrial and Transportation Averages (i.e., where they both record their last highs or lows). Turning to the weekly chart of the Averages on page 2, note that the last confirmed or joint highs in this market were made in early 1972. Transports recorded their high on April 7, 1972, and Industrials reached a peak of 968.92 a few days later. As far as Dow Theory is concerned, the main upward progress for the market ended there, in April, 1972. At no point did both Averages move higher together.





From the April highs, a decline took Industrials to 910.45 on July 20. Transports continued down, recording their low of 212.24 three months later on October 20. Following the October low, the two Averages rallied again, and this time Transports topped out December 11 at 240.41. Industrials hit their peak a month later on January 11, 1973, at 1051.70. This meant that we saw the 1972 lows, then an advance to an all-time high on Industrials which was unconfirmed by Transports. The 1972 lows now assume an outstanding importance.



On the upside the late 1972-73 rally looked very poor technically, and this was discussed repeatedly in these reports. Selling (if one owned stocks) should have taken place on the basis of the repeated and flagrant series of Transport non-confirmations. One of the criticisms of Dow's Theory is that it gets you in or out of the market "too late" or "after the fact." This is amateur nonsense, since no true Dow Theorist has ever advocated waiting for an actual bull or bear signal before buying or selling. For example, all the action of late last year, all the many non-confirmations in the Averages, indicated that the market was under distribution from informed sources and that selling was in order. I had written many times that the Vietnam cease fire had been fully discounted. I had stated that the business boom was a known fact and that too was probably fully discounted. Subsequent events proved this only too clearly.

At any rate, with the rally from the mid-1972 lows failing to take Transports to new confirming highs (above 275.71), we have the possibility of a major primary bear re-confirmation if the two Averages turn down and break their mid-1972 lows. On January 19, 1973, Transports rendered half of a bear signal by smashing below their 212.24 low of October, 1972. The Industrial low of 910.45 (recorded on July 20, 1972) now stands as the critical and confirming downside point for the market.

The market by all "normal" standards is now heavily oversold. Yet some of the worst declines in history have materialized during areas where normal measurements say "oversold." What happens is that the market "simply stays oversold." Whether we are to rally from the current area or continue down I do not know. Furthermore, there isn't an analyst, an investor or a prophet on the face of this earth who can provide that answer. We should remember that the 910.45 Industrial low of last year is the critical point. If this low is broken by Industrials, I would say that we could see this market enter one of the most dramatic and painful liquidation phases of any seen since the 1930's.

A current observation: On all rallies from this area (at least so far), Transports have acted singularly poorly, barely budging up regardless of the yardage tacked on by Industrials. This is hardly the kind of technical action I would expect to fuel good upward correction from here. And this is doubly true because Transports have suffered such a severe collapse since their early 1973 high (one would expect at least a technical rebound on the part of the carriers. So far — nothing).

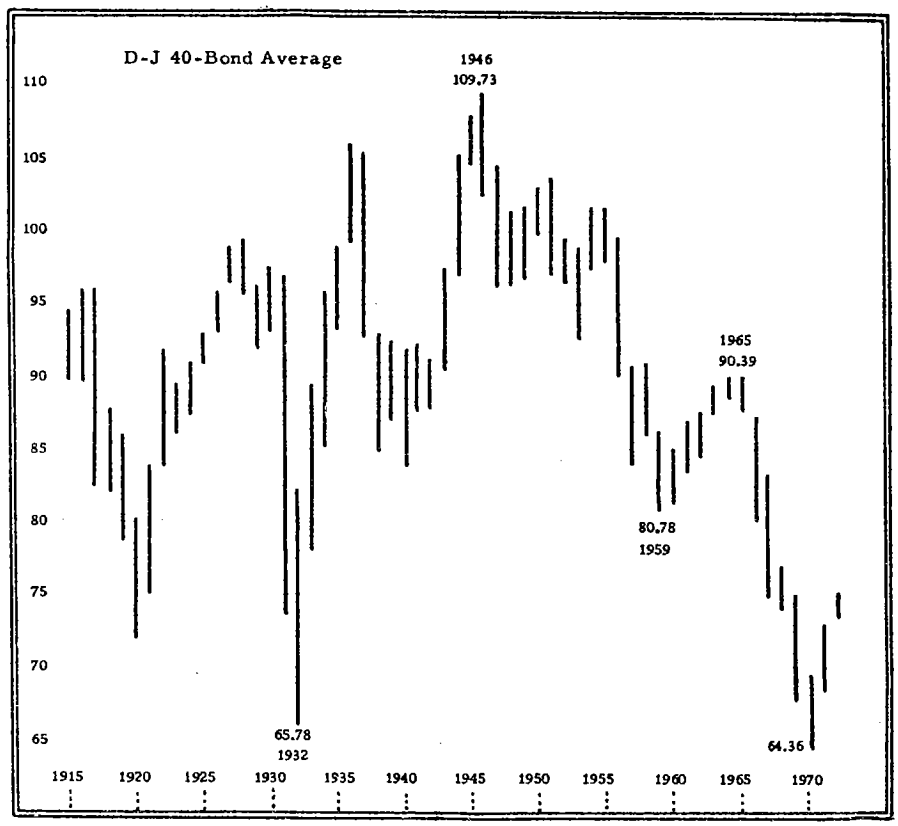
One of the phenomenons of this market since the 1972 highs has been the collapse in the advance-decline ratio as seen on the chart on this page (a long range chart of the A-D ratio was shown in the last Letter). This "across-the-board" cave-in is not to be taken lightly, for it means that billions of dollars worth of market values have eroded away. Many analysts pooh-pooh the drastic decline in the A-D ratio by saying that this only means that the run-of-the-mill stock is not doing well, and that the problem now is "simply a matter of selection."

On February 2 the Wall Street Journal ran what I thought was an ominous front page story regarding the concentration by funds and institutions in a limited number of the outstanding growth stocks. In some cases, ran the article, the institutions own 50% of the outstanding shares of given issues! With this kind of "non-distribution," the article wondered what would happen if the urge to sell ever hit these institutions. One service stated that P/E ratios for 30 famous growth stocks are now running 50% above the average of the 1962-71 period. "Without exception the stock market in the past has corrected such excesses," says this advisory.

To me this means that the Averages, many of them propped up by such growth issues as Sears, Kodak, IBM, Proctor & Gamble, could easily tumble to much lower levels. In this way, they could catch up to the rest of the market as profiled by the A-D ratio.

SHORT-TERM: The question on everyone's mind seems to be, "When will the carnage be over, at least on a short-term basis?" Translation, "When will the market rally?" Here is the rundown on a few of my best short-term indicators (subscribers should save back issues of the Letters so they can refer to previous charts): "Will-go," based on stock/bond yield ratios, is predicting an upturn for the period of April 4 to 10, the upturn to last for at least a month (Letter 554, page 3) The Aaa bond/T-bill yield ratio (Letter 554) hit 1.22 last week, lowest in months, but this could be reaching for a bottom. The 20-day total of the A-D ratio (see Letter 555, page 4) is still in heavily oversold territory, having hit an extraordinary 494 on March 1st. The indicator has been oversold for 22 consecutive trading days, a long time. Prognosis: The market has been outstandingly weak and is also outstandingly oversold. Massive downside compression often leads to explosive rallies.

BONDS: I publish the accompanying chart at least once each year, and I believe this annual high-low tracing of the D-J 40 Bond Average provides an outstanding long-term perspective of the bond market.



Bull and bear markets in bonds tend to last far longer than bull and bear markets in common stocks. The chart shows that since 1914 there have been four bear markets in bonds and three bull markets. But the bear market which began after World War II, in 1946, is obviously of such massive, long-term and persistent proportions that it almost needs a new name to describe it. From the 109.73 of 1946, the D-J Bonds plunged in 1970 to 64.36 (actually below the 1932 low). Since then there has been a mild recovery.

Last year (1972) the range of the 40 Bonds was 75.07 to 73.41, one of the tightest ranges in history. The entire bear market in bonds has erased 45.36 points from the 40 Bond Average (from the 1946 high to the 1970 low). The rise from the 1970 low of 64.36 to the 1972 peak of 75.07 represented a recoup of 17% of the losses since 1946. That's small consolation for those who have been holding bonds for the last decade or so.

In the broad scheme of things, the great bear market in bonds has been brought about by continuing inflation and higher interest rates, unrelenting pressure as bond buyers demanded higher and higher yielding bond coupons to compensate them for losses and future losses due to inflation. Thus, the billions of dollars in losses sustained in the bond market reflect a lack of faith in the stability of the dollar. The bond buyers who will not buy a good bond unless it yields 7% is implicitly saying, "Give me a yield so fat that I will be willing to sweat out inflation and the erosion of the dollar." And for a quarter of a century, that fear-based demand has been growing more insistent. That is why we are experiencing the highest yields in 100 years today; that is why the bond market is near its lowest level in history.

GOLD: Einstein was once asked about the infinite. "There are only two things which are infinite," the venerable professor stated, "space and human stupidity." Evidently the US Government has taken Einstein's words totally to heart. As to space, we have spent untold billions on our space program, a program which could have been undertaken at far less cost if it had been done in cooperation with other governments. Regarding our money and gold, the US Government seems to retain untold faith in human stupidity.

Believe it or not, Administration leaders are still spending a good deal of time and energy trying to find ways to get people to believe in paper and political promises rather than gold. Almost daily some politician, agency-head or newspaperman mouths off about the need for a "new system" which will downgrade or eliminate the yellow metal. These gentlemen don't understand that you can't legislate away 5,000 years of trust in a precious metal which has its value grounded in everything from Roman coins to the Bible. And even while they rant against gold, the peoples of the world continue to buy the metal at progressively higher prices, in fact the highest prices in world history.

Unfortunately, the official propaganda has succeeded in confusing the public, and this, I feel, is the basic reason why the gold share boom has not yet begun. For even while the American public stays out of the gold share market, the investment money, the international money, the oil money, the hedge money, the knowledgeable money, has had a field day for picking up gold bullion and gold mining shares are what I feel will be looked back upon as bargain prices.

In the February 26 Wall Street Journal (back page) appears a large article claiming that gold users and jewelry makers are looking for gold substitutes, and that dentists are trying to move to gold alloys (shades of the alchemists). The Journal also talks about jewelers who are trying to sell brass covered gold (but people complain about the weight). In the meantime, the New York Times carries an ad from a concern which advertises 18 carat gold jewelry sold "by weight." The latter, of course, is a legal way to buy gold.

And the San Diego Union (owned by the huge Copley outfit) on February 27 brought out a pathetic editorial which talks about the need to "deal with the psychology of gold."

The Union would like to "dampen public trust in the precious metal." How's this for an idea: Why don't we tell the world that dollars are gold and gold is dollars. Then, if they believe it, there will be a run on dollars and people will sell gold to buy greenbacks. On reading this a friend suggests a different twist. "Why doesn't the US make it legal for citizens to own gold. Then six months later the US confiscates all the gold and reimburses the owners with micro-SDR's."

Actually, and in all seriousness, what I see ahead (and I have written this before) is a steady collapse in confidence in all paper currencies with a gradual awakening by the peoples of the world to the fact that the more paper the governments print, the more paper is required to buy an ounce of gold. This will set off a new and much more broad-based panic into gold, and the price of the metal will rocket up far beyond what seems "possible" today.

People ask me how high I think gold will go. I can only answer that gold must go high enough so that the dollar can be fully convertible and so that everyone will know that there is no sense in speculating on any further "new high" price for gold. It must go high enough so that people will sell gold, not buy it. But it will be absolutely essential that US inflation be ended along with the new "dollar convertible" price for gold. What is my personal guess as to this theoretical price at this time? At this time I would say that gold should go to $150 to $200 an ounce with inflation utterly halted in the US. This would build the foundation for a stable monetary system.

I can not emphasize enough that new parities, new adjustments, devaluations, manipulations will not provide any lasting "solution" to the monetary mess. The solution lies with the fundamental task of the US being able to sell as much of, or more, than it buys from foreign sources. Everything else is nonsense. This solution entails an ending of inflation here, at a time when inflation is virulent. It does not matter that the rest of the world is also inflating. They are inflating from a much lower base, and the fact is that the US is now running a trade deficit with every major developed area in the Free World. Ultimately, the US or the rest of the world (or both) will have to confront the fundamentals. At that time gold will win. The reason: Gold is always honest, politicians are seldom honest.

Meanwhile, the S. African mines are doing very well indeed at the higher prices for gold, and of course they will do even better in 1973 since the average price for gold during first quarter 1973 promises to be considerably higher than the price during anytime in 1972. I am indebted to Indicator Digest, Palisades Pk, NJ 07650, for the following statistics regarding selected S. African gold mines. All of these stocks are available via ADR's and all have been recommended repeatedly in these reports.

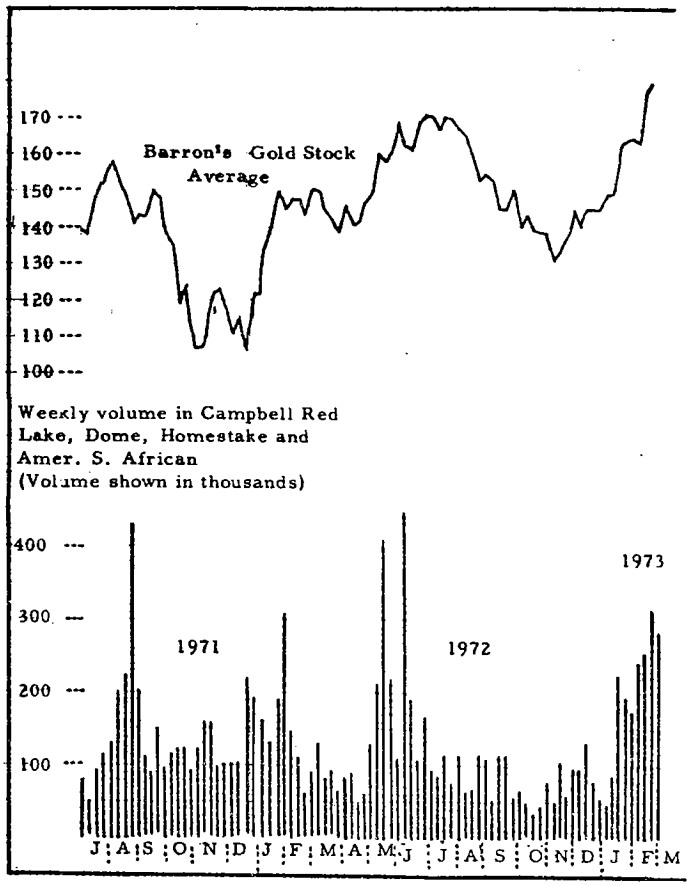
SOUTH AFRICAN GOLD STOCKS (KAFFIRS)

Revenues, Earnings and Dividends for the 6 Months Ended 12/31/72
Compared with the 6 Months Ended 12/31/71

	Revenues $ Millions	% Increase	Earnings Per Share	% Increase	Dividend Paid	% Increase
Blyvooruitzicht	33.00	30%	.24	15%	.21	25%
Free State Geduld	83.47	22%	2.63	26%	2.42	31%
Kloof	30.41	62%	.55	200%	.21	400%
President Brand	72.65	24%	1.96	-7%	1.54	3%

President Steyn	53.27	33%	1.08	124%	.38	80%
Vaal Reefs	118.02	50%	2.63	147%	.78	10%
Welkom	38.69	25%	.50	46%	.46	68%
Western Areas	35.12	18%	.54	58%	.23	129%
Western Deep Levels	108.65	41%	2.09	36%	1.14	23%
Western Holdings	91.54	28%	3.60	41%	3.34	38%

In predicting an ultimate public stampede into gold shares, it is helpful to possess a gauge of "gold interest." The gauge I use is volume in the four listed NYSE gold vehicles, Dome, Campbell, Homestake and American S. African. The accompanying chart shows Barron's Gold Stock Average and the weekly volume in the four listed gold shares. As seen on the chart, the new record highs in the gold bullion price and the steep rise in gold shares did not create any particular excitement from the standpoint of gold share volume.



I would think that when the public comes in for the gold shares we might see volume in the four listed golds jump to well over a million shares per week or more than triple the volume of recent weeks. At any rate, if and when the gold volume comes we will see it on this chart.

COMMENTS on selected Dow stocks based on long-term point & figure charts.

Allied Chem: Little risk here, trend bullish, next bull target — 37.

Amer. Tel: Not too much risk here either with huge double bottom at 41. Higher (competitive) bond yields could drive it lower, however.

Anaconda: Bettered a downtrend line which has held this stock in a bear trend for 5 years. The stock is bullish with a base which could easily take it to 30. One of the best bets.

DuPont: A mainstay of the Averages, gave bearish signal recently at 172. Breaking down now after big rise since 1970.

Kodak: Turned bearish when it hit 136 in February; another mainstay of the Dow.

GE: Holding its main bull uptrend since 1970, but minor trend turned bearish when stock hit a recent 66.

GM: Gave two bearish signals recently, one at 77 and one at 75. GM remains bearish and crucial point is 71. Hitting 71, the technical situation here would collapse.

Goodyear: Looks "cheap," but technical picture turned very bearish here when GT touched 26.

Johns Manville: Gave very bearish signal in Nov. 1971, at 37, and new bearish signal in January, 1973, at 27. Drastic collapse from 1971 high of 46 to current price in mid-20's.

Owens-Illinois: A technical horror story with recent break of the 1970 bottom at 37. Stock down from 1969 high of 81 to present price in mid-30's.

Swift: Recent price of 30 breaks a triple bottom. Something drastically wrong at SWX if you want to believe the technical picture (story in current Forbes).

Westinghouse: A technical collapse when it hit 37, I would sell this stock on all rallies.

Woolworth: Down from 1971 price of 55, this blue-chip broke its 1970 bottom when it hit 25. The 1966 bottom was $19\frac{1}{2}$, and I feel that the stock offers minimum downside risk at its current crash-price.

STOCKS: Amer. S. African, the bellwether of the gold industry, is now correcting following its major move up from the low 40's. OBV, relative strength and momentum are all in strong uptrends, but the stock is too far above its moving average (now at 49.5). Actually a correction back to the 50 level would be technically "healthy" for ASA.

I listed five Dow stocks in the last Letter which I thought were outstanding in terms of technical strength, two of which were Allied Chem. and Anaconda. Allied, which is also an oil producer, has held like a rock on the 1973 selling, and this can be seen in the spurting relative strength (RS) line. All the other indicators look OK on ACD, although the odd-lotters are moving towards the buying side on this issue (whereas it would be preferable if they were moving towards selling or higher ratios).

Anaconda, recommended repeatedly here, has an outstanding RS line, and the stock hit a high for the year last week (quite a feat in this market). Anaconda had massive odd-lot selling during 1972, but that skepticism is now easing up considerably. The drop in OBV is a bit disconcerting in this stock. For this reason, I would say that those who have bought it for a trade hang on — but those who did not leave it alone.

LATE COMMENT: The period just ahead promises to be particularly interesting. The consensus seems to be that Europe will bail the US out with a simple "joint float" against the dollar, and lo, the third devaluation will be upon us. This is to help US exports more than ever, and it will slow foreign imports. Remember, businessmen run Japan, and they also are very powerful in Germany. France thinks the US is a blackmailer. So my comment is, don't count on a painless Common Market bailout for Uncle Sam.

The market has bounced up from an oversold area, but I suspect this is just an intermediate rally. Very few Dow stocks have any technical bases here, and most are simply "pulling back" from downside penetrations.

SECOND NOTE: Just received a letter from Marty Zweig who informs me that "By the way, I really enjoy reading your letters ... especially the non-stock market things, believe it or not." All right Marty, you asked for it. The next report is going to carry a "Thoughts" piece that I couldn't fit into this mailing. By the way, I got the Zweig address wrong, it is 300 W. 46th St., NYC 10017.